

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
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Telephone Number:

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CC:TEGE:EB:HW  
PLR-111065-12  
Date:  
July 31, 2012

### Legend

City =

State =

Agreement A =

Agreement B =

Agreement C =

Agreement D =

Agreement E =

Dear :

This is in response to your letter of March 2, 2012, in which you request rulings on behalf of City concerning the proper treatment of contributions that are made to a retiree health trust and account. City is a charter city and is a political subdivision of State. City entered into Agreements A through E with employee groups that require City and employees to contribute to a retiree health trust and account. Under each Agreement,

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City is required to contribute a specified percentage of an employee's base salary to fund retiree medical benefits. Employees are also required to contribute a specified percentage of base salary. The retiree health trust makes distributions payable to City's health plans to subsidize retiree medical coverage. Employer and employee contributions may also be held in a general account by City. According to the information submitted, City's employees may not elect to receive salary in lieu of making the mandatory contributions.

Section 61(a)(1) of the Internal Revenue Code (the Code) and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

However, § 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 3101 imposes taxes under the Federal Insurance Contributions Act (FICA) on an employee's wages. Section 3306 imposes taxes under the Federal Unemployment Tax Act (FUTA). Sections 3121(a) and 3306(b) provide that, with certain exceptions, for FICA and FUTA tax purposes, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. However, §§ 3121(a)(2) and 3306(b)(2) provide that the term "wages" does not include any payment (including any amount paid by an employer

for insurance) made to or on behalf of an employee or any of his dependents, for medical or hospitalization expenses. Section 3401(a) of the Code provides that for purposes of federal income tax withholding, "wages" means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. However, Rev.

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Rul. 56-632, 1956-2 C.B. 101, holds that when premiums paid by an employer under policies providing hospital and surgical services are excludable from the employees' gross income under section 106 of the Code, the amounts paid by the employer are not subject to federal income tax withholding.

Rev. Rul. 75-539, 1975-2 C.B. 45, describes two labor contracts. Contract A provides that upon retirement, an employee will receive a portion of accumulated unused sick leave credits as a cash payment or, at the election of the employee, the payment may be applied to continue the employee's participation in the employer's health plan. Contract B provides that the value of a portion of the accumulated unused sick leave credits will be used to pay for continued participation in the employer's health plan. Under no circumstances, under Contract B, may the retired employee, or his spouse or dependents, elect to receive this payment in cash.

Rev. Rul. 75-539 holds that, under Contract A, the value of unused accumulated sick leave credits used to continue health coverage is includible in the retired employee's gross income. However, under Contract B, the value of the unused accumulated sick leave credits is excludable from the retired employee's gross income.

Based on the information submitted and representations made, we conclude as follows:

(1) Mandatory employee contributions that are made to the retiree health trust or to City's retiree medical benefits account pursuant to Agreements are treated as employer contributions and are excludable from City employees' gross income under § 106 of the Code.

(2) Mandatory employee contributions made pursuant to Agreements are not "wages" and are not subject to FICA taxes under § 3121(a), FUTA taxes under § 3306(b) or income tax withholding under § 3401(a) of the Code.

No opinion is expressed concerning the Federal tax consequences under any other provision of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker  
Branch Chief, Health and Welfare  
Office of Division Counsel/Associate Chief  
Counsel (Tax Exempt and Government Entities)